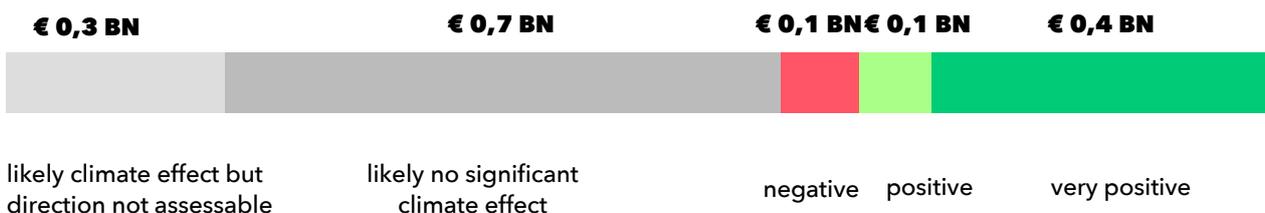


GREEN RECOVERY TRACKER REPORT: LATVIA

The Latvian draft Recovery and Resilience plan (RRP) was published in January 2021, following public consultations at the end of 2020. The measures of the RRP are organised into six areas: climate change and sustainability, digital transformation, economic transformation and productivity reform, health, inequality and the rule of law. Further 2% (€ 33mio.) of the total investment is planned in the field of culture and media, covering several of the components of the RRP.

Overall, the Latvian RRP includes measures worth €1.65bn (or 5% of domestic GDP). The plan makes a moderate contribution to the green transition, but falls short on ambition. Our analysis identifies the following spending shares:



In focus: Green Spending Share

We find that Latvia's draft recovery plan (RRP) achieves a green spending share of 29%, below the EU's 37% climate spending benchmark. In contrast, 6% (€0,1bn) of all measures have a negative impact. Furthermore, we find that almost 17% (€0.28 bn) may have a positive or negative impact on the green transition depending on the implementation of the relevant measures, illustrating the importance of further scrutiny during the planning, review and implementation of the recovery measures.

Our calculation of the green spending share aims to mirror the approach used for the official assessment of national recovery plans, which distinguishes between measures contributing fully to climate mitigation (100% coefficient) and measures contributing only partly (40% coefficient). Therefore, we fully count "very positive" measures towards the green spending share, while "positive" measures are weighted using a coefficient of 40%, which is applied to the associated costs. All individual assessments can be accessed via the country page on our website.

OUR HIGHLIGHTS

Good Practice

Green transportation system

The RRP comprises 18% of measures to green the Riga transport system, including electrification of trains, upgrades to trains to reduce GHG emissions, purchase of emissions-free public transport, building bicycle and park & ride infrastructure. These investments are essential to reduce transport emissions in the city.

Bad Practice

Lack of genuine structural reforms

The Latvian plan details a list of investment projects but does not include necessary structural reforms to ensure these investments are properly absorbed. It, therefore, falls short on one of the key goals of the EU Recovery and Resilience Facility: incentivizing critical structural reforms in member states.

To Our Surprise

The greening of transport system of Riga metropolity area

The government is planning to green the transportation system of the Riga metropole area. The measures are quite complex and target various parts of the Riga transport system. However, further actions are needed in order to change social practices like moving people from cars to greener forms of mobility.

GENERAL CONTEXT

The political debate surrounding the COVID-19 pandemic in Latvia has been dominated by discussions on the state of the economy, trying to find the balance between reducing infection rates and shutting down business activity.

Latvia's per capita GDP is much lower than the EU average (at 51%), but its economy was not hit as hard by the pandemic as many other EU countries were. In 2020, Latvia's GDP only decreased by 3.5% and it is expected to grow by 3.5% in 2021. Unemployment rates only rose by 2.1% during the pandemic.

Context indicators¹	Latvia	EU average
GDP (2019)	30.5 bn €	
GDP (per capita, 2019)	15920 €	31130 €
GDP (per capita, 2020, provisional)	15430 €	
Debt (% of GDP, 2019Q4)	44.6%	77.6%
Debt (% of GDP, 2020Q3, provisional)	70.0%	89.8%
Unemployment Rate (December 2019)	6.5%	6.5%
Unemployment Rate (August 2020)	8.6%	7.7%
Real GDP forecast for 2020	- 3.5%	- 8.3%
Real GDP forecast for 2021	+ 3.5%	+ 5.8%
Total recovery spending	4.44bn €	
EU recovery funding (grants only, current prices)	1.65bn €	

KEY FOCUS AREAS OF THE LATVIAN RECOVERY DEBATE AND THE RECOVERY PACKAGE

Latvia's Recovery and Resiliency Plan is supposed to be based on the Resiliency Strategy for Latvia for Mitigating the Consequences of the COVID-19 Crisis (May 2020), which aims to set out a strategic framework with a comprehensive set of measures to overcome the pandemic-induced impacts on the economy, focusing not only on economic stabilization but also on economic reorientation and the exploitation of growth opportunities created by the crisis. However, the main aim of the plan is to boost economic growth. In accordance with that, the Latvian government's strategy focuses on human capital, innovation, business environment, export capacity, access to finance and infrastructure development.

So far, there has not been any recognizable public debate on the RRP measures, only few organizations have officially commented on the draft plan. There has been more public

debate over some of the individual recovery measures financed from the national budget, such as a one-time payment of €500 to families for every child¹.

The current version of the Latvian RRP draft deals with the need to respond to the following challenges:

- High greenhouse gas (GHG) emissions and a low share of renewable energy in the transport sector, as well as low energy efficiency in the economy;
- low level of digitalization of companies and level of digital skills compared to the EU average;
- significant socio-economic differences and inequalities between Riga and other regions of Latvia;
- limited access to health services and insufficient funding in the health care system;
- productivity, which is only 50% of the EU average, low investment in R&D;
- the large share of informal economic activity and low anti-money laundering capacity;
- insufficient capacity of public administrations to implement rapid and successful reforms, insufficient knowledge in the application of public procurement and state aid rules, the high administrative burden and low level of public confidence in public administration.

To deal with these challenges the Government has divided the available resources among six priority areas: (1) Climate change and sustainability (37%); (2) Digital transformation (20%); (3) Reducing inequalities (20%); (4) Health (11%); (5) Economic transformation and productivity reform (10%); (6) Rule of law (2%).

FINANCING AND ADDITIONALITY IN LATVIA'S RECOVERY PACKAGE

Recovery measures are primarily financed from the Recovery and Resiliency Facility and co-financed mostly by other EU funds. However, some national funding sources are also included.

Most of the measures included in the package are the ones that the government has not had a chance to provide funding for before, e.g. renovation of fire stations and the renewal of educational equipment.

¹ The main discussion was if families with children are the ones suffering most from the Covid-19 related economic restrictions and whether they should deserve a special support. Later on, a similar one-time subsidy was provided also to pensioners and peoples with disabilities.

GOVERNANCE OF THE RECOVERY PACKAGE

According to the draft RRP, the implementation process of the Plan will be similar to the implementation process of the EU Structural funds and will be ensured within the existing management and control system, i.e. the Ministry of Finance as the Managing Authority, line ministries, including industry experts and industry authorities, the Central Finance and Contracts Agency as the liaison body.

However, there is no specific climate governance of the package foreseen. It should be noted that climate and energy policy in Latvia is supported by the National energy and climate board which is a multi-stakeholder institution chaired by the prime minister. Unfortunately, the board has not been involved in the development of the RRP.

NOTEWORTHY SHORT-TERM LIQUIDITY AND STATE AID DECISIONS ("COMPANY BAIL-OUTS")

The Latvian government released a €4bn bailout package for businesses. Most of this money was invested in the following measures²:

- The government covered 75% of the costs of pandemic-induced sick leave or workers' downtime, of up to €700 per month;
- A postponement of tax overdue for up to three years if the lateness in payments was due to the pandemic;
- Simplification and speeding-up of tax refunds for entrepreneurs and the decision of the Latvian government to forego personal income tax advances in 2020;
- Deferral of tax payments in crisis-affected sectors for a period of up to three years. Expected cost: €196m;
- State and local government authorities released firms from rent obligations;
- Liquidity measures for firms in all sectors: refund of the approved amount of VAT to all taxpayers within 30 days after VAT return has been submitted, as well as a VAT refund that has been carried forward in previous periods (expected cost- €60m);
- Personal Income Tax (PIT) taxpayers were exempt from advance payments for the taxation year 2020 (expected cost- €35m);
- Loans for up to 3 years for companies to finance new working capital (up to €200m);
- Loan guarantees (up to €715m), so that an enterprise facing short-term cash flow problems can postpone the payment of the principal until the situation is resolved.

The National Finance Institution Altum provided guarantees for SMEs:

- Individual guarantees of up to €5m per beneficiary, offering 50% guarantee for a maximum of two years, and;
- Working capital loans of up to €1m per beneficiary, for 18 months.

Additionally, Fintech initiatives were launched to alleviate the liquidity problems of entrepreneurs³ and the government supported a hackathon among small firms to find solutions to the crisis⁴.

The tourism sector was hit particularly hard by the crisis, impacting the national airline airBaltic, Riga Airport, and Tallink (a shipping company). AirBaltic received €250m as the government increased its share in the airline. There was no climate-conditionality attached to this support.

In 2021 additional funding was allocated to families with kids (a one-time payment of €500 per kid) and pensioners and people with disabilities (a one-time payment of €200 per person).

In 2020 the state paid almost €40m to farmers to remedy the effects of COVID-19, of which about half went to dairy farmers. In 2021, the government decided to allocate another €45.5m to the Ministry of Agriculture to support the agricultural sector, but this time most of the support was intended for pig farmers.

DEEP DIVE: THE MOST IMPORTANT RECOVERY MEASURES AND HOW WE ASSESSED THEM

The most important measures with an effect on the green transition are:

- Greening the transport system in the Riga metropolitan area (€295m, very positive)

This measure includes electrification of trains, upgrades to trains to reduce GHG emissions, purchase of emissions-free public means of transport, building bicycle and park& ride infrastructure. All of the individual measures are positive in terms of reducing transport sector emissions and can potentially bring significant results in improving air quality in the city (there is currently an infringement procedure in place against Latvia over poor air quality in Riga). However, there is a risk that these

measures will not be enough to change the behaviour and habits of commuters who still tend to own their own vehicles.

- Adaptation of transport and machinery required for farms (including agricultural production) and enterprises to operate with biomethane (€10m, direction not assessable)

This reform received a lot of criticism from various environmental groups and renewable energy associations on the basis that it focuses resources primarily on the development of biomethane infrastructure, which will bring only marginal results in overall transport emissions reductions. Moreover, there is no funding for electrification foreseen (no grants or administrative or tax stimuli) for the entire transport sector (cars account for the largest share of GHG emissions from the transport sector). There were also significant concerns raised that this measure could lead to market distortions. There are concerns about the plans to make it mandatory to purchase certified biomethane (thus ensuring the demand for biomethane) for those who have been supported via the Recovery and Resilience Fund (RRF) in purchasing biomethane-powered vehicles or retrofitting existing vehicles for the use of biomethane (municipalities, the fire service, and farmers). These beneficiaries could end up being obliged to purchase more expensive energy. The plan, moreover, is to connect this newly built biomethane infrastructure to existing fossil gas infrastructure (the fossil gas industry will be providing service for the biomethane compression). There is a risk, therefore, that this measure might lock-in continued fossil gas use.

- Improving the energy efficiency of apartment buildings and the transition to the use of renewable energy technologies (€37m, very positive)

The measure includes improving the energy efficiency of apartment buildings through renovation measures and scaling up the use of renewable energy technologies in buildings. The measure itself could potentially have a high positive impact on emissions reductions and could, critically, also reduce energy poverty. However, too little funding has been allocated for this investment (it is planned to renovate 182 multiapartment buildings) and there remains a risk that it will fall short of achieving the target of renovated apartment buildings by the year 2030 (According to the Latvian Energy Strategy 2030, the average energy consumption of multifamily

building stock should be decreased from the actual 160-180 kWh/m² to 100 kWh/m² until 2030). There is, moreover, considerable funding for renovating public sector buildings (€54.9 million) relative to multi-apartment buildings (€36.63 million), despite the fact that it is much easier for the state and municipalities to borrow funds for such purposes than it is for residents in multi-apartment buildings to do so.

- Investments in GHG emissions sequestration and promoting forest sustainability - replacement of unproductive forest stands, afforestation, care of young forest stands. (€22m, direction not assessable).

This investment can be seen controversial as e.g. so called 'unproductive' forests are in many cases habitats of the utmost European importance. Yet there have been no guarantees provided that this measure will not destroy or negatively affect these habitats. This measure also raises doubts over whether it will provide a net-positive impact from an emissions perspective. These activities would allow for long-term CO₂ absorption from the atmosphere only if it was ensured that the harvested wood is used exclusively for building materials and furniture; however, the measure lacks sufficient guarantees that the timber will not end up being used for activities that result in absorbed CO₂ being released back into the atmosphere.

The package also contains a significant number of measures that do not directly relate to the green transition but are still important and potentially transformative:

- **Inequality**

Road renovation in rural (and infrastructurally less connected) regions as part of the following measure: "Administrative territorial reform, improvement of the national regional and local road network for the accessibility and safe accessibility of the administrative centers of the new counties and the services and jobs provided therein" (€102m, negative)

- **Economy**

An innovation cluster program, which focuses on increasing R&D capacity for businesses - with the intention of increasing productivity, higher added value product, as well as new product development (€78m, direction not assessable).

A further overview of the most important measures by sector can be found in the annex, below.

ANNEX: MOST IMPORTANT MEASURES OF THE RECOVERY PACKAGE BY SECTOR

Sector	Most important measures with an impact on the green transition
Energy	<ul style="list-style-type: none"> • Biomethane infrastructure development for use in transportation - although this measure is formally included under support for transportation, it might be more important for the energy sector in long-term due to plans to connect it with fossil gas infrastructure (€0.01bn, direction not assessable) • Establishment of a system of proofs of origin for biomethane (€0.02bn, positive)
Mobility	<ul style="list-style-type: none"> • Measure within Latvian RRP 'The greening of the transport system of Riga metropolis area' (€0.3bn, very positive) • Improvement of the national regional and local road network for the accessibility and safe accessibility of the administrative centers of the new counties and the services and jobs provided therein (€0.1bn, negative)
Industry	<ul style="list-style-type: none"> • Support for increasing energy efficiency in business (including the transition to the use of renewable energy technologies in heat supply and related research and development activities (including bioeconomy) (€0.08bn, very positive)
Buildings	<ul style="list-style-type: none"> • Energy efficiency measures for multi-apartment buildings (€0.04bn, very positive), private enterprises and municipal (€0.03bn, very positive) and state buildings (€0.03bn, positive)
Agriculture	<ul style="list-style-type: none"> • Flood prevention infrastructure upgrade measures, forestry production improvement measures under RRP (€0.02bn, direction not assessable)
Cross-cutting	<ul style="list-style-type: none"> • Increasing energy efficiency in business (including the transition to the use of renewable energy technologies in heat supply and related research and development activities (including bioeconomy), which is planned to be implemented nationally in the form of a combined financial instrument (€0.08bn, very positive) • Modernization of administration and digital transformation of services, including the business environment (€0.07bn, direction not assessable) • Support for the creation of a network of Digital Innovation Centers and

regional digital agents (€0.01bn, direction not assessable)

- Support for process digitization in business to increase productivity (€0.04bn, direction not assessable)
- Support for the introduction of new products and services in business (€0.03bn, direction not assessable)

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